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SUBJECT: GOC MISSES GOAL OF BALANCED BUDGET WITH PROJECTED
2009 DEFICIT OF 0.88 PERCENT OF GDP

REF: ZAGREB 826

11. SUMMARY: The 2009 budget approved by the Croatian parliament includes an approximate 4 percent increase in spending to 127 billion HRK (\$24 billion) and an approximate 5 percent increase in revenues to 124.6 billion HRK (\$23.5 billion). The resulting deficit is projected to equal 0.88 percent of GDP. Although the government reduced the deficit from its original proposal, adding any amount to the national debt could prove problematic as the GOC faces more difficulties accessing finance in the current economic conditions. END SUMMARY.

12. On December 15, the Croatian parliament approved a 2009 budget of 127 billion HRK (\$24 billion) in expenditures and 124.6 billion HRK (\$23.5 billion) in revenues. These amounts represent increases of just over 4 percent in spending and about 5 percent in revenues from 2008 amounts. The budget assumes 2 percent growth in GDP and a drop in inflation to 3.5 percent for 2009. The deficit is projected to equal 0.88 percent of GDP.

13. The draft budget the government submitted to parliament on December 5 had a projected deficit of 1.6 percent of GDP, despite PM Sanader's repeated earlier pronouncements that he would propose a balanced budget for 2009 as a key measure to help Croatia deal with the global economic crisis. He was unable to do so, however, partially due to a failure to convince government and state-enterprise employees to delay a previously promised 6 percent pay increase in 2009 (reftel). The president of the leading opposition party, the Social Democrats (SDP), criticized the GoC's budget proposal as "deeply inadequate" to address the financial crisis and said the SDP would not "waste time" proposing amendments. The World Bank publicly urged the GOC to reduce the proposed deficit and some members of Sanader's advisory Economic Council also raised concerns.

14. In an indirect response to the criticism, Sanader said his ministers would propose amendments to further cut expenditures and bring the deficit below 1 percent of GDP. Most of this reduction was then taken from the Ministry of Health, which was due to receive the largest increase in spending (24 percent over 2008 expenditures) in the December 5 draft to implement a major healthcare reform. Nearly 90 percent of the additional cuts of 1.9 billion kuna came from delaying expenditures under the healthcare reform program.

15. Despite the smaller projected deficit, concerns about the approved budget remain. The chief economists from three leading banks in Croatia told the press the government's assumption of 2 percent growth in GDP is too optimistic. Their forecasts range from 1.6 percent to below 1 percent. The senior economist at the World Bank Croatia office also told us the projected deficit is still too high given the expected economic conditions for 2009 and negative credit

rating forecasts for Croatia.

16. COMMENT: Absent the global economic crisis, the 2009 budget deficit might have been considered a success for bringing the deficit below 1 percent a year ahead of the government's proposed deficit reduction schedule. As the effects of the economic crisis make it difficult for the GOC to finance its current debt, however, the prospect of adding anything more to that debt in 2009 raises legitimate concerns. Given the concerns that the 2 percent GDP growth estimate may prove overly optimistic, however, the GOC will struggle just to keep the deficit at the projected 0.88 percent of GDP, much less shrink it any further.

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